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In the Supreme Court
OF THE
United States

OCTOBER TERM 1945

No. 834

LA SOCIETE FRANCAISE DE BIENFAISANCE MUTUELLE (a corporation),
Petitioner,

vs.

UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI
to the Circuit Court of Appeals for the Ninth Circuit
and
BRIEF IN SUPPORT.

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Subject Index

Page

I. Petition for writ of certiorari:
- Summary statement of the matter involved..... 2
- Opinion below 6
- Statement of basis of jurisdiction..... 7
- Questions presented 7
- Reasons relied on for allowance of the writ..... 8

II. Brief in support of petition:
1. Opinion of the court below..... 13
2. Statement of jurisdiction 14
3. Concise statement of the case..... 14
4. Specification of errors..... 14
5. Summary of argument 14

Argument

1. The Circuit Court of Appeals erred in refusing to give effect to the intention and purpose of Congress to exempt "hospitals not operated for profit" 15
2. The Circuit Court of Appeals erred in holding that the treatment of non-member patients is one of the "purposes" for which petitioner was organized and is operated... 23
3. It is established that the clause, "no part of the net earnings of which inures to the benefit of any private shareholder or individual", refers to the use, and not the source, of such earnings 27
4. The Commissioner abused his discretion in denying the refund of (a) employees' taxes accrued before the 1939 reversal in ruling; (b) interest on all taxes from the various dates when same allegedly first became due, and (c) penalties imposed for non-payment 33

III. Appendix: Page

1. Authorities holding that "charity" is not limited to almsgiving or gifts to the poor, but that its legal meaning is more comprehensive than its popular significance..... 38
2. Authorities holding non-profit hospitals to be per se charitable corporations..... 39
3. Authorities holding that the test of a charity is to be found in the purpose for which the institution is founded and exists and that the motives of, or benefit to, a donor or settlor are immaterial..... 42
4. Authorities holding that the fact a non-profit institution makes a charge against members, or that its inmates pay a consideration on their admission, or that a non-profit school or hospital makes some charge to help defray the cost of its operation, does not affect its charitable character 42
5. Authorities holding that the restriction of benefits to its own members does not affect a non-profit institution's charitable character 43

Table of Authorities Cited

Cases	Pages
Andrews v. Young Men's Christian Association, 226 Iowa 374, 284 N. W. 186	43
Barden v. Atlantic Coastline Ry. Co., 152 N. C. 318, 67 S. E. 971	41
Barnes v. Providence Sanitarium, 229 S. W. 588	40
Bedford v. Colorado Fuel & Iron Corp., 102 Colo. 538, 81 Pac. (2d) 752	39
Better Business Bureau v. United States, 326 U. S. ....., 90 L. Ed. 76, 66 S. Ct. 112	9, 23, 25, 26, 33
Beverly Hospital v. Early, 292 Mass. 201, 197 N. E. 641, 100 A.L.R. 1332	41
Board of Commissioners v. United States, 308 U. S. 343, 352, 60 S. Ct. 285, 84 L. Ed. 313	36
Brattleboro Retreat v. Town of Brattleboro, 106 Vt. 228, 173 A. 209	39
Buchanan v. Kennard, 234 Mo. 117, 136 S. W. 415, Ann. Cas. 1912D 50	20, 40
Bull v. United States, 295 U. S. 247, 79 L. Ed. 421, 55 S. Ct. 695	34
Butterworth v. Keeler, 219 N. Y. 446, 114 N. E. 803	22
Carr v. Northern Pacific Beneficial Ass'n, 128 Wash. 484, 221 Pac. 981	40
Carter v. Whitcomb, 74 N. H. 482, 69 Atl. 779	43
City of Dallas v. Smith, 130 Tex. 225, 107 S. W. (2d) 872	41
City of Indianapolis v. The Grand Master, etc., 25 Ind. 518	43
City of Palestine v. Missouri-Pacific Lines H. Ass'n, 99 S. W. (2d) 311	41
Commissioner of Internal Revenue v. Battlecreek Inc., 126 F. (2d) 405	22, 39
Commissioner of Internal Revenue v. Kensico Cemetery, 96 F. (2d) 594	9, 30
County of Henepin v. Brotherhood of Gethsemane, 27 Minn. 460, 38 A. R. 298	39
Darcey v. O'Brien, 65 Fed. (2d) 599	38
District of Columbia v. Mt. Vernon Seminary, 100 Fed. (2d) 116	9, 32

Pages

Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189..... 28
Enell v. Baptist Hospital, 45 S. W. (2d) 395..... 41
Episcopal Academy v. Phila., 150 Pa. 565..... 43
Ettlinger v. Trustees of Randolph-Macon College, 4th Circ., 31 Fed. (2d) 869 38
Estate of Henderson, 17 Cal. (2d) 853..... 43
Estate of Lowe, 326 Pa. 375, 192 Atl. 405, 111 A.L.R. 518.. 42
Estate of Lubin, 186 Cal. 326.....24, 43

Fire Insurance Patrol v. Boyd, 120 Pa. St. 624, 6 A.S.R. 745, 1 L.R.A. 417 42
Fordyce & McKee v. Women's Christian Nat. Library Ass'n, 79 Ark. 550, 96 S. W. 155..... 42

Galveston H. & S. A. Ry. Co. v. Hanway, 57 S. W. 695.... 41
Garrison v. State, 64 Cal. App. (2d) 820, 149 P. (2d) 711 35
German Hospital v. Board of Review, 233 Ill. 246, 84 N. E. 215 39
Gossett v. Swinney, 53 Fed. (2d) 772..... 38

Harrison v. Barker Annuity Fund, 98 Fed. (2d) 286.....38, 42
Hearns v. Waterbury Hospital, 66 Conn. 98, 33 Atl. 595... 40
Hibernian Benevolent Society v. Kelly, 28 Ore. 173, 42 Pac. 3, 30 L.R.A. 167, 52 A.S.R. 769..... 43

Illinois Central R. Co. v. Moodie, 23 Fed. (2d) 902..... 41
In re Buck (1896), 2 Ch. 727 43
In re McDowell, 217 N. Y. 454, 112 N. E. 177..... 42
In re Mendelsohn, 262 App. Div. 605, 31 N.Y.S. (2d) 435..22, 39
In re Rust's Estate, 168 Wash. 344, 12 Pac. (2d) 396.....22, 39
In re Y.M.C.A. Retirement Fund Inc., 18 B.T.A. 139..... 42

Kemper Military Academy v. Crutchley, 274 Fed. 275..... 24
Koon Kreek Klub v. Thomas, 108 Fed. (2d) 616..... 9, 31

La Societe Francaise de Bienfaisance Mutuelle v. California Employment Commission, 56 Cal. App. (2d) 534, 133 P. (2d) 42 34
Little v. City of Newburyport, 210 Mass. 414, 96 N. E. 1032 42
Long v. Rosedale Cemetery, 84 Fed. 134..... 38
Lutheran Hospital Ass'n v. Baker, 40 S. D. 226, 167 N. W. 148 39

Page

Magnuson v. Swedish Hospital, 99 Wash. 399, 169 Pac. 828 40
Manhattan General Equipment Co. v. Commissioner, 297 U. S. 129, 134, 80 L. Ed. 528, 56 S. Ct. 397 36
Maretick v. South Chicago Community Hospital, 297 Ill. App. 488, 17 N. E. (2d) 1012 40
Markham v. Cabell, 326 U. S. ....., 90 L. Ed. 168, 66 S. Ct. 193, 195 35
McDonald v. Mass. Gen'l Hospital, 120 Mass. 432, 21 Am. Rep. 529 41
Miami Battlecreek v. Lummus, 140 Fla. 718, 192 So. 211 41
Miller v. Mohr, 198 Wash. 619, 89 Pac. (2d) 807 41
Morrow v. Smith, 145 Ia. 514, 124 N. W. 319 43
Most Worshipful G. L. of A. F. & A. M. v. Board of Review, 281 Ill. 480, 117 N. E. 1016 43
Mulliner v. Evangelischer Diakonniessenverein, 144 Minn. 392, 175 N. W. 699 40

New England Sanitarium v. Inhabitants of Stoneham, 205 Mass. 335, 91 N. E. 385 ..... 22, 39

Old Colony Trust Co. v. O. M. Fisher Home, Inc., 301 Mass. 1, 16 N. E. (2d) 10 42
Old Colony Trust Co. v. Welch, 25 Fed. Supp. 45 38
Ould v. Washington Hospital, 95 U. S. 303 20

Parsons v. Childs, 345 Mo. 689, 136 S. W. (2d) 327 42
Pease v. Pattinson, L. R. 32 Ch. Div. 154, 55 L. J. Ch. N.S. 617, 54 L.T.N.S. 209 43
Pennsylvania Co. v. Helvering, 66 Fed. (2d) 284 (Ct. App. Dist. Col.) 38
People v. Morton, 373 Ill. 72, 25 N. E. (2d) 504 42
People v. Sexton, 267 App. Div. 736, 48 N. Y. Supp. (2d) 201 39
Piedmont Memorial Hospital v. Guilford County, 218 N. C. 673, 12 S. E. (2d) 265 40
Powers v. Massachusetts Homeopathic Hospital, 101 Fed. 896 38

Redfield v. Ystalyfera Iron Co., 110 U. S. 174, 3 S. Ct. 570, 28 L. Ed. 109 36
Reynolds Memorial Hospital v. Marshall County Court, 78 West Va. 685, 90 S. E. 238 41

Pages

Richardson v. Carbon Hill Coal Co., 10 Wash. 656, 39 Pac. 95 40
Roche's Beach Inc. v. Commissioner, 96 Fed. (2d) 776.... 9, 30
Rush Hospital Benev. Ass'n v. Board of Sup'rs, 187 Miss. 204, 192 S. 829 39

Santa Fe Lodge No. 460 B.P.O.E. v. Employment Security Commission, 159 Pac. (2d) 312 (New Mex., May 1945) 38
Santee Club v. White, 87 Fed. (2d) 5..... 9, 31
Scofield v. Corpus Christi Golf & Country Club, 127 Fed. (2d) 452 ..... 9, 31
Scripps Memorial Hospital v. California Employment Commission, 24 Cal. (2d) 669, 151 Pac. (2d) 109..... 39
Slee v. Commissioner, 42 Fed. (2d) 184.....22, 24
Southern etc. Sanitorium v. Wilson, 45 Ariz. 522, 46 Pac. (2d) 118, 77 Pac. (2d) 458..... 41
Spiller v. Maude, 11 L.T. (N.S.) 329..... 43
State v. H. Longstreet Taylor Foundation, 198 Minn. 263, 269 N. W. 469 .....22, 39
Stuart v. City of Easton, 3rd Circ., 74 Fed. 854..... 38
Summers v. Chicago Title & Trust Co., 335 Ill. 564, 167 N. E. 777 43

Texas Central R. Co. v. Zumwalt, 103 Texas 603, 132 S. W. 113, 30 L.R.A. (N.S.) 1206..... 40
Thomas v. Postal Telegraph-Cable Co., 48 S. W. (2d) 422 41
Todd v. Citizens' Gas Co., 7th Circ., 46 Fed. (2d) 855.... 38
Trinidad v. Sagrada Orden, 263 U. S. 578, 44 S. Ct. 204, 68 L. Ed. 458 ..... 9, 28

Union & New Haven Trust Co. v. Eaton, 20 Fed. (2d) 419 (D.C. Conn.) 38
Union Pacific Railway Co. v. Artist, 60 Fed. 365.....40, 42
United States v. Proprietors of Social Law Library, 102 Fed. (2d) 481 .....9, 24, 30, 43

Virginia Mason Hospital v. Larson, 9 Wash. (2d) 284, 114 Pac. (2d) 976 .....22, 40

Waterbury Savings Bank v. Danaher, 128 Conn. 78, 20 Atl. (2d) 455 35

Pages

Wells v. Ferry Baker Lumber Co., 57 Wash. 658, 107 Pac. 869, 29 L.R.A. (N.S.) 426 40
Westport Bank & Trust Co. v. Fable, 126 Conn. 665, 13 Atl. (2d) 862 42
Widows' and Orphans' Home of O. F. v. Commonwealth, 126 Ky. 386, 103 S. W. 354 43

Constitution and Statutes

Calif. Corporation Act of 1850, Chapter VIII (Stats. 1850, p. 373) 3
California Labor Code, Sec. 216 ..... 11, 35

House Report:
No. 615, p. 15 17
No. 615, pp. 22, 33 18
No. 1540, 74th Congress, 1st Session 16

Income Tax Regulations 111, (1943) Sec. 29.101-1, p. 314 .. 27
Internal Revenue Code:
Sec. 101(5)(7)(9) 23
Sec. 101(6) 10
Sec. 861(a)(3) 10
Sec. 1004(a)(2)(B) 10
Sec. 1426(b)(8) 3
Sec. 1607(c) (7) 3

Judicial Code:
Sec. 128(a) 7
Sec. 240(a), (43 Stat. 938, Act of February 13, 1925, U.S.C. Title 28, Sec. 347(a)) 7

Opinion of Attorney General, Vol. 40, No. 72 ..... 8, 19

Senate Report:
No. 628, p. 27 17
No. 628, pp. 33, 45 18
Social Security Act:
49 Stat. c. 531, p. 620 2
Secs. 811(b)(8), and 907(c)(7) 2

	Page
26 United States Code:	
Sec. 3612(d)	36
Sec. 3770(a)(1)	36
Sec. 3791(b)	36
28 United States Code, Sec. 347(a)	7

Miscellaneous

Bogert on Trusts:	
Vol. 2, pp. 1114-15	42
Vol. 2, pp. 1124-25	43
Vol. 2, pp. 1126-27	42
Vol. 2, p. 1163	41
Vol. 2, pp. 1163-64	38
Corp. Jur. Secun. Vol. 10, p. 297	27
Corp. Jur. Secun. Vol. 14, p. 411	38
Enc. Brit., 14th (1936) Ed., Vol. 5, p. 248	20
Scott on Trusts, (1939), p. 1996	41
Trusts, Restatement, Sections 372, 376	41
Vital Statistics—Special Reports, Hospital and other Institutional Facilities and Services, 1939, Vol. 13, No. 2, p. 7	10
Webster's (New Int. Dictionary)	17
Zollman on Charities, p. 188	41

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No.

LA SOCIETE FRANCAISE DE BIENFAISANCE MUTUELLE (a corporation),
Petitioner,

vs.

UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

Your petitioner, La Societe Francaise de Bienfaisance Mutuelle, of San Francisco, California, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered December 3, 1945, (rehearing denied January 2, 1946),

in an action numbered and entitled on its docket, No. 11,029, *United States of America,* Appellant, vs. *La Societe Francaise de Bienfaisance Mutuelle,* a corporation, Appellee, reversing the judgment of the United States District Court for the Northern District of California, Southern Division, in favor of petitioner for the sum of $35,269.85, this being the amount of taxes, interest and penalties which it had paid, under the Social Security Act,[1] for the years 1936-1942, inclusive.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

In 1937 the Commissioner of Internal Revenue held that petitioner, as a charitable corporation, was exempt (R. 45). In 1939, this ruling was reversed (R. 46). The reason for the change does not appear, but the Commissioner's letter states that "it appears you are not operated for profit" (R. 45-46). Petitioner, in addition to *its own* tax ($21,719.29), has paid $13,550.56 for *employees'* taxes which had accrued before this reversal, interest and heavy penalties (R. 15).

Petitioner contends that, as a nonprofit corporation whose membership is unlimited and whose only purpose is the operation of its hospital and the treatment of the sick (R. 38), it is a "charitable" corporation within the meaning of Sections 811(b)(8) of Title VIII, and of Section 907(c)(7) of Title IX, of the

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[1] 49 Stat. c. 531, p. 620.

Social Security Act,[2] each of which provides that "the term 'employment' does not include";

> "Service performed in the employ of a corporation, community chest, fund or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Petitioner was founded in San Francisco in 1851 (R. 38). In 1856, it was incorporated by the filing of a certificate which, under the statute,[3] stated only that the members had elected certain named trustees and had determined that they and their successors should forever be known by petitioner's present name (Plff. Ex. No. 11, R. 168). Prior to 1941 (R. 90, 119), a by-law provided:

> "The Society is founded on the basis of mutuality for the treatment of sick members; neither political not religious questions can ever be considered in its midst."

Since petitioner's activities are by no means confined to "the treatment of sick members", this is evidently an *admonition* as to political or sectarian activities.

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[2]Now I.R.C. Sections 1426(b)(8) and 1607(c)(8).

[3]Chapter VIII of Corporation Act of 1850, "Relating to Religious and other Associations or Societies" (Stats. 1850, at p. 373).

Petitioner has no capital stock, and no interest, dividends or other pecuniary distributions have ever been paid to anyone (R. 38-39). Its directors, who manage its affairs, serve without compensation (R. 39). Any net earnings have always been devoted to the improvement of its plant and the betterment of its services (R. 39, 156).

During the period involved, membership has averaged about 9,800 (R. 43). Their number is unlimited, and it has always admitted new members, (R. 43, 163, 181). Admission to membership is limited to persons (wholly or partly) of French birth or origin, or speaking French, (this is applied with liberality), or the spouse or child of a qualified member (R. 117, 142).

Petitioner owns and operates in San Francisco a large modern hospital[4] equipped to treat every kind of illness (R. 40), with a capacity of two hundred twenty-five beds and a nursery for children. The hospital site and buildings represent its principal asset, in addition to which it has moderate reserves. The services of the hospital are not restricted to members, but it is open to the public without distinction as to race, creed or color (R. 40). It provides for the training of interns (R. 41), and at large expense maintains a nurses' training school (R. 41).

Monthly dues are $1.75, but children, one of whose parents is a member, pay one dollar (R. 43). Life

[4]Approved by American Medical Association and by American College of Surgeons as a Class "A" Hospital (R. 40).

members, who have prepaid in full, otherwise have the same rights and privileges.

Continued payment of dues is not, however, a condition to relief. In the case of indigent member-widows and of other needy members, such dues are paid from petitioner's *relief fund* set up, in 1905, for that purpose (R. 78-79). A member under seventeen years, if orphaned or abandoned by his parents, pays no dues, nor do members in the armed forces of the United States, nor do student nurses, when members (R. 43). It gives other forms of purely gratuitous relief (R. 42).

The benefits are remarkable in their extent, variety and duration (R. 44). To its members and to the public, petitioner gives other very substantial services, either gratuitously or at cost (R. 42).

During its existence, petitioner has received donations and bequests aggregating $362,822.63 (R. 39) which, with the income therefrom, has amounted to over $500,000, or more than half its assets (R. 85). Without them, it could not have acquired its present plant nor give the service it renders (R. 39). In times of need, it has received other forms of public assistance (R. 171-173).

In its eight fiscal years ending February 29, 1944, petitioner has had *no* net income. Disbursements exceeded receipts by $35,283.96. Surplus decreased $65,682.95, (R. 80, 156). Improvements and maintenance amounted to $125,000. In the seven years ending February 28, 1943, disbursements had exceeded

receipts by $105,134.08. In the eight-year period, somewhat less than half of petitioner's total receipts was from non-member patients. *The latter pay only the prevailing rates in San Francisco* (R. 143-144). Normally, member patients greatly out-number others, (Plff. Ex. No. 10, R. 168). In addition, in those eight years, members' calls and consultations in the out-patient department averaged 33,734 per annum (R. 75). In June, 1944, there were about eight hundred members in the armed forces (R. 167).

Moreover, the 1944 excess in receipts was temporary, because appellee's hospital, like others, has been operated to capacity (R. 158). When conditions are again normal, receipts will decline, but wages and other expenses will probably continue permanently higher. The 1944 "profit" will have been illusory.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is reported in 151 Fed. (2d) ....., and appears in the record (R. 196). The opinion of the District Court (R. 29-37) is reported in 57 Fed. Supp. 201.

Briefly, the reasoning of the Circuit Court is that, to be exempt, petitioner "must be devoted to charitable purposes exclusively"; that treatment of non-member patients is a substantial "non-charitable purpose" and constitutes a "business venture" and an independent "field"; that, by reason of these expanded operations and the enlarged income therefrom, its

plant and facilities were improved, and that this was a valuable service "which inured to the benefit of members."

STATEMENT OF BASIS OF JURISDICTION.

The judgment of the Circuit Court of Appeals was entered December 3, 1945 (R. 195). Rehearing was denied January 2, 1946 (R. 206).

The three months' period for filing this petition begins to run from January 2, 1946. Jurisdiction of this court is invoked under Act of February 13, 1925, Ch. 229, Sec. 1, 43 Stat. 938, as amended, Judicial Code, Sec. 240(a), U. S. C. Title 28, Sec. 347(a).

Jurisdiction was conferred on the District Court by Section 24, Twentieth, of the Judicial Code, as amended. Its judgment was entered October 13, 1944, (R. 56-58). Within three months, and on January 9, 1945, notice of appeal was filed (R. 58) pursuant to Section 128(a) of the Judicial Code, as amended.

QUESTIONS PRESENTED.

Whether the Circuit Court of Appeals erred:

1. In refusing to give effect to the intention and purpose of Congress to exempt "hospitals not operated for profit";

2. In holding that the treatment of non-member patients is one of the "purposes" for which petitioner was organized and is operated;

3. In holding that the clause, "no part of the net earnings of which inure to the benefit of any private shareholder or individual", has reference to the *source,* instead of the *use,* of petitioner's earnings, and that *receipt* of payments by such non-member patients, rather than the *use* thereof, determines its charitable character within the meaning of the Act;

4. In holding that petitioner is not entitled to recover the employees' tax ($6,195.77) which accrued before the 1939 reversal in ruling, which it paid from its own funds and for which it was not reimbursed; penalties ($4,996.05), and interest ($2,358.74).

REASONS RELIED UPON FOR ALLOWANCE OF WRIT.

1. The legislative history of the Act makes it unmistakably clear that Congress intended to exempt "hospitals not operated for profit". Hence, on November 2, 1943, the Attorney General, in a written opinion to the President, held that such legislative history "clearly shows that the language of the exemption in the statute was adopted by the Congress with knowledge that it had been construed to exclude nonprofit hospitals", and that Congress intended that "the exemption of the Social Security Act would receive the same construction," (40 Op. A. G. No. 72, infra, p. 19).

The opinion of the Circuit Court ignores this basic aid to construction, disregards and thwarts the inten-

tion of Congress, and substitutes for the determination of Congress its own view as to the desirability of exempting non-profit hospitals such as that of petitioner.

2. The decision of the Circuit Court of Appeals ignores, but is directly contrary to, *Trinidad v. Sagrada Orden,* 263 U. S. 578, 44 S. Ct. 204, 68 L. Ed. 458, which holds that exemption is not lost by using income, from whatever source, to further the purposes which are made the basis for the exemption.

The decision entirely misconceives, and so is directly contrary to, *Better Business Bureau v. United States,* 326 U. S. ....., 90 L. Ed. 76, 66 S. Ct. 112, where the corporation's "purposes" are held to be controlling.

3. The decision directly conflicts with

Commissioner v. Kensico Cemetery, 2d Circ., 96 Fed. (2d) 594;

Koon Kreek Klub v. Thomas, 5th Circ., 108 Fed. (2d) 616;

United States v. Proprietors of Social Law Library, 1st Circ., 102 Fed. (2d) 481;

Roche's Beach, Inc. v. Commissioner, 2d Circ., 96 Fed. (2d) 776;

Santee Club v. White, 5th Circ., 87 Fed. (2d) 5;

Scofield v. Corpus Christi Golf & Country Club, 5th Circ., 127 Fed. 452;

District of Columbia v. Mt. Vernon Seminary, 100 Fed. (2d) 116;

all of which hold that exemption is not lost as long as profits are retained by the organization or are used to further the purposes which are made the basis for the exemption, and are *not otherwise* used for the benefit of any private shareholder or individual.

The opinion in this case confuses petitioner's "purposes" with the *means* by which such "purposes" are accomplished, and ignores the settled distinction between *source* and *destination* of income.

4. The question involved is of general importance. The same exempting clause appears in the income tax, estate tax, and gift tax acts.[5]

There is also involved the tax liability of other non-profit hospitals. Over forty-two per cent (2,967 out of 6,991) of all hospitals in this country are "non-profit".[6] They consist of "church, fraternal or other association controlled institutions", and embrace fraternal, railroad, lumbering, steel and many other large employee groups, (Railroad hospitals alone, have well over half million members). All are non-profit, and many are maintained for, and largely supported by, *dues-paying* members. Congress has not distinguished

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[5]I.R.C. Sec. 101(6), 861(a)(3), 1004(a)(2)(B).

[6]"Vital Statistics—Special Reports, Hospital and other Institutional Facilities and Services, 1939", Vol. 13, No. 2, p. 7, issued by Bureau of the Census. Out of 6,991 hospitals, 2,967 (42.44 per cent) are there classed as "nonprofit", 1,729 (24.74 per cent) as "government", and 2,295 (32.82 per cent) as "proprietary".

as between the various kinds of these non-profit hospitals.

5. After the 1937 ruling, petitioner refunded to its employees the taxes theretofore deducted. Thenceforth until 1939, when the ruling was reversed, it discontinued such deductions altogether. Not to have done so would have been a misdemeanor, (Calif. Labor Code, Sec. 216). When the earlier ruling was reversed, it was obliged to pay all earlier *employees'* taxes from its own funds. Moreover, petitioner was required to pay interest on all alleged delinquencies from original due dates, and even heavy penalties for non-payment. This was one of the grounds of the claims for refund, (R. 16).

Denial of relief constituted a palpable abuse of the Commissioner's discretion. It offends common sense, and the moral sense, that, where the *creditor* denies the debt, the taxpayer must pay a heavy additional penalty for not paying that which in no case would have been accepted. Also, in the absence of contract, interest is awarded as damages for *wrongful* detention. A correct determination of this is important to the orderly administration of the revenue laws.

WHEREFORE, petitioner prays that a writ of certiorari issue out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and send to this Court, for its review and determination, on a day certain to be therein named, a full and complete transcript of the record

and of all proceedings in said case numbered on its docket 11,029, that the judgment of said Circuit Court be reversed, and that petitioner have such other and further relief in the premises as to this Court may seem proper.

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OCTOBER TERM 1945

No.

LA SOCIETE FRANCAISE DE BIENFAISANCE MUTUELLE (a corporation),
Petitioner,

vs.

UNITED STATES OF AMERICA.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINION OF THE COURT BELOW.

A reference to the official report of the opinion of the Circuit Court of Appeals (R. 196) is set forth in the petition, (p. 6). That reference is adopted here.

II.

STATEMENT OF JURISDICTION.

A concise statement of the grounds on which the jurisdiction of this court is invoked is given in the petition (p. 7), and, by reference thereto, is adopted here.

III.

CONCISE STATEMENT OF THE CASE.

A summary of the matter involved is given in the petition (p. 7). To avoid duplication, that statement is incorporated herein as a concise statement of the case.

IV.

SPECIFICATION OF ERRORS.

The errors intended to be urged are those specified in the petition as the questions presented and numbered 1-4 (p. 7), all of which are specifically assigned as error.

V.

SUMMARY OF ARGUMENT.

1. The Circuit Court of Appeals erred in refusing to give effect to the intention and purpose of Congress to exempt hospitals not operated for profit.

2. The Circuit Court of Appeals erred in holding that the treatment of nonmember patients is one of the "purposes" for which petitioner was organized and is operated.

3. The clause, "no part of the net earnings of which inures to the benefit of any private shareholder or individual", refers to the use, and not the source, of income;

4. The Commissioner abused his discretion in denying the refund of (a) employees' tax which had been accrued before the 1939 reversal in ruling; (b) interest on all taxes from various dates when same first allegedly became due, and (c) penalities imposed for non-payment.

ARGUMENT.

I.

THE CIRCUIT COURT OF APPEALS ERRED IN REFUSING TO GIVE EFFECT TO THE INTENTION AND PURPOSE OF CONGRESS TO EXEMPT "HOSPITALS NOT OPERATED FOR PROFIT".

The history of the Social Security Act conclusively establishes that Congress considered *"hospitals not operated for profit"* to be "charitable" and intended to exempt them. This explicity appears from the action of the conferees of both Houses.

Such intention was expressly declared when the conferees were considering the amendments to the bill. They then said that it was unnecessary to exclude such hospitals *in terms* since, by the settled construction

of identical language in the income tax law, they were *already* within the definition of "charitable" corporations.

The Record (Cong. Rec. Vol. 79, Part 10, pp. 11,321 and 11,323, amendments Nos. 15 and 81) shows that, in the sections in question, the Senate had proposed the addition of *"or hospital"*. In conference, the Senate receded for the reason that these words were *surplusage*. Thus, the statement of the Managers for the House appended to the Conference Report[7] states:

> "The Senate amendment adds to the list of purposes *'or hospital'* as a clarifying amendment. The Senate recedes, the conferees omitting this language as *surplusage,* based on the fact that *the internal revenue bureau had uniformly construed language in the income tax laws identical with that found in the house bill, as exempting hospitals not operated for profit,* and also on the fear that the insertion of the words added by the Senate amendment might interfere with the long-continued construction of the income tax law." (Emphasis added)

From this it is apparent that:

1. The Act must be read as if its language were, "religious, charitable, scientific, literary, or educational, *or hospital,* purposes". This is what Congress intended.

2. Congress considered that "hospitals not operated for profit" were "charitable" institutions.

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[7]H.R. No. 1540, 74th Congress, 1st Session.

3. The report *itself construes* the clause, "no part of the net earnings of which inures to the benefit of any private shareholder or individual", as inapplicable to nonprofit hospitals. Since Congress intended to exempt "hospitals not operated for profit", it evidently considered that they satisfied the requirements of this clause.

4. *All* nonprofit hospitals were treated alike. *All* were exempted, and not merely *some* of them. The exclusion was not of "free", or "charitable", or "nonmember", hospitals. The only test is, "operated for *profit*". What Congress did *not* wish to exempt were the 2,295 "proprietary" hospitals.

The Commissioner's letter to petitioner of February 24, 1939, states that *"it appears you are not operated for profit"* (R. 45-46). The government cannot point out how many of the 2,967 "nonprofit" hospitals shall be denied exemption, nor by virtue of what principle of differentiation.

One-fourth of all employees (9,389,000 out of 37,743,000), were intentionally excluded. Among those excluded, were *"institutional* workers".[8] The House and Senate reports each states:[9]

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[8]Webster (new Int. Dict.) defines an "institution" as, "An established or organized society or corporation, an establishment, especially one of public character or one affecting a community." Petitioner is an "institution".

[9]H. Rep. No. 615, p. 15, Sen. Rep. No. 628, p. 27.

"Total number of gainful workers	48,830,000
Total number of owners, operators, self-employed (including the professions)	12,087,000
Total of workers *excluded* because of occupation (farm labor, domestics, teachers, and governmental and *institutional workers*)	9,389,000
Total number of workers in eligible occupations	27,354,000"

In each report (H. Rept. pp. 22, 33, Sen. Rep. pp. 33, 45) there twice appears an explanation of "charitable". All four are virtually identical. Thus (H. Rep. p. 33):

> "Services performed in the employ of religious, charitable, scientific, literary, or educational institution, no part of the net earnings of which inures to the benefit of any private shareholder or individual, are also exempt from the tax imposed by this title. For the purpose of determining whether such an organization is exempt, the *use to which the income is applied is the ultimate test of the exemption rather than the source from which the income is derived.* For instance, if a church owns an apartment building from which it derives income which is devoted to religious, charitable, educational, or scientific purposes, it will not be denied the exemption. The organizations which will be exempt from such taxes are churches, schools, colleges, and other educational institutions not operated for private profit, the Y. M. C. A., the Y. W. C. A., the Y. M. H. A., the Salvation Army, and other organizations which are exempt from income tax

under section 101 (6) of the Revenue Act of 1932" (Italics ours).

The opinion rendered by Attorney General Biddle to the President (40 Op. A. G., No. 72) in part states:

"Investigation discloses, however, that the Bureau of Internal Revenue's interpretation of the statute is in accord with its interpretation of similiar language contained in the income tax law, which interpretation was made some years prior to the enactment of the Social Security Act, and apparently has been consistently followed.

"In addition, the legislative history of the Social Security Act shows that the conferees eliminated a specific amendment exempting hospitals as surplusage on the ground that the language in the income tax law, identical with that contained in the House bill, has been uniformly construed by the Bureau of Internal Revenue as exempting hospitals not operated for profit, 'and also on the fear that the insertion of the words added by the Senate amendment might interfere with the continuation of the long-continued construction of the income-tax law.' H. Rept. 1540, 74th Cong., 1st sess., p. 7. Thus, the history clearly shows that the language of the exemption in the statute was adopted by the Congress with knowledge that it had been construed to exclude nonprofit hospitals. This, I think, demonstrates congressional approval of that construction and evidences the intention that the exemption in the Social Security Act should receive the same construction."

Although the intention of Congress is not in doubt, so that any extended discussion is unnecessary, it may not be improper briefly to set forth the principles by which the charitable character of an institution is determined. The supporting authorities appear in the appendix.

1. "Charity" is not limited to "almsgiving" nor to gifts to the poor. Its legal meaning is far more comprehensive. Neither is it limited to any narrow or stated formula, (Appen. p. 38).

2. "Charity" represents "both a personal and a social endeavor to ameliorate the conditions which exist in society", (Enc. Brit., 14th (1936) Ed., Vol. 5, p. 248). "It has no necessary relation to relief or alms. It may mean a consideration shown for the welfare of others either individually or generally", (Id., p. 249). Any nonprofit institution ministering to a fundamental human need (old age, education, sickness or religious worship) is, per se, a "charity".

Ould v. Washington Hospital, 95 U. S. 303, 311, declares that a charitable use refers to "almost anything that tends to promote the well-doing and well-being of social man". A nonprofit hospital, though not confined to the poor, is a public charity, (Buchanan v. Kennard, 234 Mo. 117, 139, 136 S. W. 415, Ann. Cas. 1914D 50). "Charitable" purposes include the "promotion of health" and "other purposes the accomplishment of which is beneficial to the community", (*Restatement Trusts,* Sec. 368).

Petitioner, with its present equipment and facilities, is the result of the acts of its founders in estab-

lishing it, of its members in continuing to maintain it, and of the gifts and legacies it has received, so that there now exists an institution whose membership is unlimited, which tends to promote the "well-doing and well-being" of the community as a whole. The test of its charitable character, and the basis for the exemption, is whether it acts for profit and the benefit derived by the public at large.

3. By the overwhelming weight of authority throughout the United States, a nonprofit hospital is, per se, a charitable institution. (Appen. p. 39).

4. The test of a charity is to be found in the purpose for which the institution is founded and exists. The motive of, or benefit to, donor or settlor is immaterial, (Appen. p. 42).

Regardless of the expectations or motives of petitioner's members as they may be from time to time, there now exists, largely from donations and bequests, an institution which, without profit, not only affords complete protection to the health of nearly ten thousand persons, but also stands ready similarly to care for all others complying with its simple and nonexclusive requirements for admission.

5. That a non-profit institution (school, hospital or home) makes a charge against members, or that inmates pay a consideration on their admission, or a charge is made to defray costs of operation, does not affect its charitable character, (Appen. p. 42).

6. The restriction of benefits to its own members does not affect a nonprofit institution's charitable

character, (Appen. p. 43). Here, however, it would be misleading to argue that petitioner restricts its benefits to its *own* members. Since membership is unlimited, it evidently seeks to spread those benefits as widely as possible.

In his opinion (R. 36-37) the trial judge stated:

> "Non-profit hospitals have frequently been held, for purposes of taxation, to be charitable institutions, although they receive paying patients, so long as a portion of their work is charitable. *Commissioner of Internal Revenue v. Battlecreek Inc.,* 126 F. (2d) 405; *In re Mendelsohn,* 31 N.Y.S. (2d) 435; *In re Rust's Estate,* 12 Pac. (2d) 396; *New England Sanitarium v. Inhabitants of Stoneham,* 91 N.E. 385; *State v. H. Longstreet Taylor Foundation,* 269 N.W. 469; *Virginia Mason Hospital Ass'n v. Larson,* 114 Pac. (2d) 976. In *Butterworth v. Keeler,* (N.Y) 114 N.E. 803, Mr. Justice Cardozo said that non-profit 'universities and hospitals are unquestionably public charities'; and in *Slee v. Commissioner,* 42 F. (2d) 184, Judge Learned Hand observed that the object to maintain health without profit 'has been a recognized kind of charity from time immemorial.'
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> "An organization such as plaintiff's is of great public benefit. It enables a person of limited means, through the payment of small monthly sums, to receive medical care without resorting to public charity. The need for such protection has long been recognized, and there has been agitation for compulsory insurance of this type. A non-profit hospital which has no stock and pays no dividends renders a public service, and I think

> Congress has clearly shown its intent to exclude such hospitals from the provisions of the Act."

We submit, therefore, that the intention of Congress to exempt "hospitals not operated for profit" appears beyond question and that the Circuit Court of Appeals erred in refusing to give effect to such intention.

II.

THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT THE TREATMENT OF NON-MEMBER PATIENTS IS ONE OF THE "PURPOSES" FOR WHICH PETITIONER WAS ORGANIZED AND IS OPERATED.

The Circuit Court has (1) confused petitioner's "purposes" with the *means* by which they are accomplished, and (2) has read "charitable" as if it were somehow defined or explained by the clause, "no part of the net earnings of which inure to the benefit of any private shareholder or individual".

This latter clause also appears in the income tax law in the provisions exempting cemetery corporations, business leagues, chambers of commerce, real estate boards or boards of trade, and recreation clubs, (I. R. C. Sec. 101(5)(7)(9). It no more enters into the definition of "charitable" than into that of "board of trade", or of "literary", or of "scientific". For example, in the *Better Business Bureau* case, the government *stipulated* that "the net earnings did not inure to the benefit of any private shareholder or

individual". Yet this did not make Bureau's "purposes" any more "educational".

Thus, a school may be operated for profit, and still be exclusively "educational", (*Kemper Military Academy v. Crutchley,* 274 Fed. 275). Or a society of book lovers is "literary", or one of scientists is "scientific", although their facilities are not free to the general public, (*United States v. Proprietors of Social Law Library,* 1st Circ., 102 Fed. (2d) 481). A church congregation is "religious", though its benefits are reserved primarily to its paying members, (*Estate of Lubin,* 186 Cal. 326, 199 Pac. 15).

"Exclusively" modifies "organized and operated". It refers to the "purposes" for which the institution is "organized and operated". *Non*-charitable "purposes" are excluded, but activities in aid of charitable "purposes" are not precluded.

Rendering medical treatment without profit to an indefinite portion of the public (petitioner's unlimited membership) and its availability to and use by the public in general is a charitable "purpose".

If, then, such "purpose" is "charitable", receipt of rents or other income, payments by non-member patients, or subletting of surplus facilities, do not change this. "Such activities are *mediate* to the primary purpose," (Learned Hand, J., in *Slee v. Commissioner,* 2d Circ., 42 Fed. (2d) 184). Income so used does not inure to "private" advantage.

For nonprofit hospitals to reduce their overhead by also caring for nonmembers helps to widen their bene-

fits. The better petitioner accomplishes this, the better it deserves and justifies the exemption. That such nonprofit institution uses receipts from nonmember patients to give more people better service at lower rates, does not change its character as a hospital "not operated for profit".

The act favors *non*-pecuniary benefits, that is, the treatment of the sick without profit. Congress exempted nonprofit hospitals because of their benefit to the entire community. The imposition of the tax upon petitioner is subversive of this public policy. To deny exemption where income, from whatever source, is applied to promote the health of a large part of the community, nullifies the intention of Congress. The added benefits to appellee's members from augmented earnings, from whatever source derived, is the purpose upon which the exemption of nonprofit hospitals is founded. Nor does petitioner benefit at the "expense" of outsiders. The latter pay only the current prevailing rates for like hospitals in the community (R. 144).

Since, therefore, petitioner's purpose—to treat the sick without profit—is a charitable one, and since any net earnings are devoted exclusively to that "purpose", it is operated "exclusively" for a charitable "purpose".

The opinion of the Circuit Court entirely misconceives, and hence directly conflicts with, *Better Business Bureau v. United States,* 326 U.S. ..... 90 L. Ed. 76, 66 St. Ct. 112, which is the converse of the pres-

ent case. The opinion in that case states that, to be exempt, "the organization must be devoted to educational *purposes* exclusively"; that the presence of a single substantial "non-educational *purpose*" will destroy the exemption, regardless of the number or importance of "truly educational *purposes*"; that "an important if not the primary *pursuit*" of the Bureau was to promote a "profitable *business* community"; that its organization was permeated by a "*commercial* hue", and that its activities were largely animated by this "*commercial purpose*", which was directed fundamentally to *non*-educational "*ends*", (Emphasis added)

Even assuming, as the opinion of the Circuit Court of Appeals states, that treatment of nonmember patients is a "business venture" and that thereby petitioner had entered into an independent "field", income from such source is nevertheless but a *means* by which petitioner accomplishes its "purpose", that is, the treatment of the sick without *profit*.

Furthermore, the opinion in the *Better Business Bureau* case emphasizes the legislative history of the Act as an important aid to its construction.

We submit, therefore, that the Circuit Court of Appeals erred in holding the treatment of non-member patients to be one of petitioner's "purposes".

III.

IT IS ESTABLISHED THAT THE CLAUSE, "NO PART OF THE NET EARNINGS OF WHICH INURES TO THE BENEFIT OF ANY PRIVATE SHAREHOLDER OR INDIVIDUAL", REFERS TO THE USE, AND NOT THE SOURCE, OF SUCH EARNINGS.

As later will appear, not only is the government's contention to the contrary an afterthought, but we have shown (supra, p. 17) that Congress has construed this clause as not applying to "hospitals not operated for profit."

Income Tax Regulations 111, (1943), Sec. 29.101-1, p. 314, state that " 'private shareholder or individual', in Section 101, refer to individuals having a *personal and private interest* in the activities of the corporation". This could scarcely be said of *each* member of a group of 9,800. A like definition of "individual" follows from the rules of *ejusdem generis and noscitur a sociis.*

Operation for profit is contemplated and permitted. What is forbidden is that "net earnings" should inure to any "private" shareholder or individual, that is, to the *private* advantage of one or more of the group. A member of petitioner, however, has "merely the right to the use thereof as long as he continues to be a member", (10 Corp. Jur. Secun. 297).

As well might it be claimed that savings resulting from petitioner's receipts from non-member patients constitute "income" to *each* member. "Net earnings" could not "inure" to the benefit of a "private share-

holder or individual" until "severed" from the general fund for his separate use and benefit, so as thereby to afford him a benefit private and peculiar to him, (*Eisner v. Macomber,* 252 U. S. 189, 40 S. Ct. 189). The distinction is between assets retained by the group in its organized capacity and individuals "privately" benefited.

Moreover, in the eight years before February 29, 1944, petitioner had *no* "net earnings", but sustained a loss of $35,283.96 (R. 156). The statute refers to the corporation's earnings as a whole. It does not treat it as departmentalized or as divided into separate income-producing units.

As we have shown, (supra p. 18), the House and Senate reports each state:

> "for the purpose of determining whether such an organization is exempt, the *use* to which the net income is applied is the ultimate test of the exemption rather than the *source* from which the income is derived."

The opinion of the Circuit Court, however, ignores this. It also ignores, and is directly contrary to, *Trinidad v. Sagrada Orden de Predicatores,* 263 U. S. 581, 68 L. Ed. 458, 44 S. Ct. 204, where a corporation sole, representing a religious order, received income by way of rents, interest, dividends, and profits on small quantities of supplies sold to its agencies. The language of the statute was identical to that here involved. Held, exempt.

> "Whether the contention is well taken turns primarily on the meaning of the excepting clause,

before quoted from the taxing act. Two matters apparent on the face of the clause go far towards settling its meaning. First, it recognizes that a corporation may be organized and operated exclusively for religious, charitable, scientific or educational purposes, and *yet have a net income. Next, it says nothing about the source of the income, but makes the destination the ultimate test of exemption.*

"Evidently the exemption is made in recognition of *the benefit which the public derives* from corporate activities of the class named, and is intended to aid them when not conducted for private gain. *Such activities cannot be carried on without money;* and it is common knowledge that they are largely carried on with income received from properties dedicated to their pursuit.".

At page 582:

"In using the properties to produce the income, it therefore *is adhering to and advancing those purposes,* and not stepping aside from them or engaging in a business pursuit."

"*Financial gain is not the end* to which they are directed." (All emphasis added.)

Id.

Similarly, the decision of the Circuit Court of Appeals directly conflicts with decisions of the First, Second and Fifth Circuits and of the Court of Appeals for the District of Columbia, all of which hold that exemption is not lost if the profits are retained by the organization or used to further the purposes

which are made the basis for the exemption. Those cases are:

Commissioner v. Kensico Cemetery, 2d Circ., 96 Fed. (2d) 594, 596.

Membership corporation deriving profits from sale of burial plots and incidental services, which were devoted to the payment of its debts and to cemetery's maintenance and improvements. Held, exempt. "The cemetery's revenues were devoted to the purpose for which the statute desires them to be exempt", that is, "to a public purpose which the tax law aims to protect".

United States v. Proprietors of Social Law Library, 1st Circ., 102 Fed. (2d) 481, 484.

Facilities of Library were open to all citizens of Boston willing to aid in its upkeep by becoming a "proprietor" or "subscriber", and were also free of charge to certain State and Federal officials. Held, exempt, though net earnings enabled it to do better work, whereby it was made more serviceable to its members, and notwithstanding that this "resulted in distributing its benefits among private shareholders or individuals".

Roche's Beach, Inc. v. Commissioner, 2d Circ., 96 Fed. 776.

Income earned by the incorporated business subsidiary of a charitable testamentary foundation, held, exempt.

Santee Club v. White, 5th Circ., 87 Fed. (2d) 5, 7.

Recreation club not taxable on profits realized on sale of small unusable portion of its property, profits inuring to members through use of club's facilities not being "benefit" within meaning of income tax law.

> "No part of the profit on the sale of real estate in question inured to the benefit of the Club's shareholders except through their use of the Club facilities, which is clearly not the benefit referred to in the exempting clause of the statute."

Koon Kreek Klub, v. Thomas, 5th Circ., 108 Fed. (2d) 616, 618;

Club leased grazing privileges on its game preserve, also granted oil lease on its entire property for present cash considerations and annual renewal rental. Proceeds used to pay mortgage on property. Held, exempt.

> "The exemption applies to profits so long as they are retained by the organization or used to *further the purposes which are made the basis of the exemption,* and are *not otherwise* used for the benefit of any private shareholder." (emphasis ours)

There was a like ruling, under similar circumstances, in *Scofield v. Corpus Christi Golf & Country Club,* 5th Circ., 127 Fed. (2d) 452.

District of Columbia v. Mt. Vernon Seminary,
100 Fed. (2d) 116, (Ct. App. D. Col.)

Act exempted "property used for educational purposes that is not used for private gain". Plaintiff's property was all used for educational purposes. No excess of receipts over expenditures had gone to incorporators or to any contributor to endowment.

> "The term 'private gain' as used in the statute, has reference only to gain realized by any individual or stockholder who has a *pecuniary interest* in the corporation and not, as appellant contends, to profits realized by the institution but turned back into the treasury or expended for permanent improvements. See Commonwealth v. Trustees Hamilton College, 125 Ky. 329, 101 S. W. 405. It is the evident intention of the statute to exempt all institutions, educational in nature, which are not *commercial* in their purpose.
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> "Congress has recognized the fundamental difference between income earned by an educational institution which is diverted into *private* use, and similar income which is dedicated to the *continued improvement* of the institution. The latter is a highly desirable use from the public point of view and equally worthy of tax exemption as the property out of which the income was produced." (emphasis ours)

We submit, therefore, (a) that receipts from non-member patients do not constitute "net earnings" inuring to the private benefit of any member, and (b) that Congress intended that the clause, "no part of the net earnings", should not apply to "hospitals not operated for profit".

Indeed, the government's contention belatedly comes as an afterthought or makeweight. In the court below, its counsel (brief p. 3) after reviewing petitioner's organization and activities, stated that "therefore, it would follow that plaintiff has qualified itself under the last portion of the exemption quoted above, i. e.

> 'the net earnings, no part of which inures to the benefit of any private shareholder or individual.' "

Similarly, in *Better Business Bureau v. United States,* 60 S. Ct. 112, the government *stipulated* to this effect.

IV.

THE COMMISSIONER ABUSED HIS DISCRETION IN DENYING THE REFUND OF (a) EMPLOYEES' TAXES ACCRUED BEFORE THE 1939 REVERSAL IN RULING; (b) INTEREST ON ALL TAXES FROM THE VARIOUS DATES WHEN SAME ALLEGEDLY FIRST BECAME DUE, AND (c) PENALTIES IMPOSED FOR NON-PAYMENT.

In addition to its own tax under Titles VIII and IX, ($21,719.29), petitioner was required to pay $13,550.56, represented by:

Employees' tax, (Title VIII), paid by appellee from its own funds and not repaid to it	$6,195.77
Penalties (under Title IX)	976.21
Penalties (under Title VIII)	4,019.84
Interest (under Title IX)	404.13
Interest (under Title VIII)	1,954.61

Deducting petitioner's own taxes for the three years after 1939, leaves $12,659.82. Employees' taxes prior to April 1, 1939, interest and penalties have, therefore, *added more than one hundred per cent* to its own obligations to the end of 1939. But for the conflict in rulings, no part of this would have had to be paid. The claims for refund set forth this reversal in ruling (R. 20).

Under such circumstances, courts make every effort to redress flagrant injustice, (*Bull v. United States,* 295 U. S. 247, 79 L. Ed. 421, 55 S. Ct. 695).

The question is not whether, as the Circuit Court held, the Commissioner was "estopped from changing his ruling that the Society was exempt", but whether he abused his discretion. That, for example, petitioner, though wholly blameless, should be required to pay penalties of $4,996.05 deeply offends the moral sense.

While in *La Societe Francaise de Bienfaisance Mutuelle v. California Employment Commission,* 56 Cal. App. (2d) 534, 552, 133 P. (2d) 42, the District Court of Appeal said that

> "the state may not belatedly hold the employer to payment where he has failed to pay, or to make the necessary deductions from his employees' wages, in reliance on an express ruling that he is not liable for the tax. As between the state and the employer, the state may not in good conscience thus place on the employer a burden which the act itself did not intend that he should bear. We are further of the view that the employer cannot be held to pay interest on contributions which

were not paid when due solely in reliance on the official ruling of non-liability."[10]

we need not here contend that the government is estopped. Probably no court would say that it can *never* be estopped.

However, petitioner is entitled to redress because of abuse by the Commissioner of the discretion which the law reposes in him. We are not dealing with the taxpayer's *own* obligation. Liability for the employees' tax is to be borne by *them*. The employer merely transmits it to the fund. After the 1937 ruling, petitioner had no alternative but to pay wages without deduction. Nonpayment would have been a misdemeanor, (Calif. Labor Code, Sec. 216).

The case is stronger in this respect than *Markham v. Cabell*, 326 U. S. ....., 90 L. Ed. 168, 66 S. Ct. 193, 195, where it was said:

> "The policy as well as the letter of the law is a guide to decision. Resort to the policy of a law may be had to ameliorate its seeming harshness *or to qualify its apparent absolutes.*" (Emphasis added).

Congress never intended that, where a ruling is reversed, the government's right to tax, interest and penalty should nevertheless under all circumstances remain absolute. The Commissioner is authorized,

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[10]This case was followed in *Garrison v. State*, 64 Cal. App. (2d) 820, 149 P. (2d) 711. *Waterbury Savings Bank v. Danaher*, 128 Conn. 78, 20 Atl. (2d) 455, goes further and allows recovery by the employer of the employer's tax which had accrued before the reversal in ruling. The case contains an extended discussion.

with the approval of the Secretary, to prescribe the extent, if any, to which any ruling relating to the internal revenue laws would be applied without retroactive effect, (26 U. S. Code, Sec. 3791(b)). He may refund penalties collected without authority, and all taxes "in any manner wrongfully collected", (Id. Sec. 3770(a)(1)). The penalty of twenty-five per cent for failure to file a return cannot be imposed where such failure "was due to a *reasonable cause and not to wilful neglect*", (Id. Sec. 3612(d)). Regulations, to be valid, must be reasonable, (*Manhattan General Equipment Co. v. Commissioner,* 297 U. S. 129, 134, 80 L. Ed. 528, 56 S. Ct. 397).

Congress did not intend to impose a penalty upon a taxpayer who, though ready to pay, was told that no tax was due and that none could be accepted. This is equally true of interest. A tender could not be made where the Commissioner disclaimed the right to receive any tax.

In the absence of contract, interest is awarded as *damages* after default, that is, on the theory of *wrongful* detention, (*Redfield v. Ystalyfera Iron Co.,* 110 U. S. 174, 3 S. Ct. 570, 28 L. Ed. 109). Moreover, as said in *Board of Commissioners v. United States,* 308 U. S. 343, 352, 60 S. Ct. 285, 84 L. Ed. 313:

> "Interest is not recovered according to a rigid theory of compensation for money withheld, but is given in response to considerations of fairness. It is denied when its exaction would be inequitable."

We submit, therefore, that the Commissioner abused his discretion in denying relief to petitioner in respect of employees' taxes paid by it from its own funds, interest and penalty.

We submit, therefore, that the Circuit Court of Appeals erred (a) in refusing to give effect to the intention and purpose to exempt hospitals not operated for profit; (b) in holding that the treatment of non-member patients is one of petitioner's "purposes", and that the fact of payments by such non-member patients, rather than the *use* thereof, determines its charitable character; (c) in holding that the clause, "no part of the net earnings of which inures to the benefit of any private shareholder or individual", has reference to the *source,* instead of to the *use,* of petitioner's earnings, and (d) in denying petitioner redress for the Commissioner's abuse of discretion in respect of employees' taxes paid by it, interest and penalties.

Petitioner respectfully urges that a writ of certiorari be issued.

Respectfully submitted,

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Authorities holding that "charity" is not limited to almsgiving or gifts to the poor, but that its legal meaning is more comprehensive than its popular significance.

14 *Corp. Juris. Secun.* 411;

Bogert on Trusts, Vol. 2, pp. 1163-4;

Pennsylvania Co. v. Helvering, 66 Fed. (2d) 284, (Ct. App. Dist. Col.);

Stuart v. City of Easton, 3rd Circ., 74 Fed. 854;

Ettlinger v. Trustees of Randolph-Macon College, 4th Circ., 31 Fed. (2d) 869;

Long v. Rosedale Cemetery, 84 Fed. 134, 136;

Harrison v. Barker Annuity Fund, 7th Circ., 98 Fed. (2d) 286;

Darcy v. O'Brien, 65 Fed. (2d) 599, (Ct. App. Dist. Col.);

Old Colony Trust Co. v. Welch, 25 Fed. Supp. 45, 58 (D.C. Mass.);

Powers v. Massachusetts Homeopathic Hospital, 101 Fed. 896 (Circ. Ct. Mass.);

Gossett v. Swinney, 8th Circ., 53 Fed. (2d) 772, 776;

Todd v. Citizens' Gas Co., 7th Circ., 46 Fed. (2d) 855;

Union & New Haven Trust Co. v. Eaton, 20 Fed. (2d) 419, 421, (D.C. Conn.);

International Reform Ass'n. v. District Unemployment Compensation Board, 131 Fed. (2d) 337, (Ct. App. Dist. Col.);

Santa Fe Lodge No. 460 B.P.O.E. v. Employment Security Commission, 159 Pac. (2d) 312, (New Mex., May 1945).

Authorities holding nonprofit hospitals to be per se charitable corporations.

(a) *Cases involving exemption from taxation:*

In re Mendelsohn, 262 App. Div. 605, 51 N.Y.S. (2d) 435, 440 (social security tax);

Commissioner of Internal Revenue v. Battlecreek, Inc., 126 Fed. (2d) 405, (income tax);

In re Rust's Estate, 168 Wash. 344, 12 Pac. (2d) 396, 398 (1932);

New England Sanitarium v. Inhabitants of Stoneham, 205 Mass. 335, 91 N.E. 385, 387, (1910);

People v. Sexton, 267 App. Div. 736, 48 N.Y. Supp. (2d) 201;

Scripps Memorial Hospital v. California Employment Commission, 24 Cal. (2d) 669, 151 Pac. (2d) 109, (social security tax);

Brattleboro Retreat v. Town of Brattleboro, 106 Vt. 228, 173 A. 209, 212, (1934);

Lutheran Hospital Ass'n v. Baker, 40 S.D. 226, 167 N.W. 148 (1918);

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Union Pacific Railway Co. v. Artist, 60 Fed. 365, (C.C.A. 8th, 1894), (Railroad hospital);

Texas Central R. Co. v. Zumwalt, 103 Texas 603, 132 S.W. 113, 30 L.R.A. (N.S.) 1206, (Railroad hospital);

Carr v. Northern Pacific Beneficial Ass'n., 128 Wash. 484, 221 Pac. 981;

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Scott on Trusts (1939), p. 1996;

Zollman on Charities, p. 188;

Trusts, Restatements, Sections 372, 376;

Bogert on Trusts (1935), Vol. 2, p. 1163.

Authorities holding that the test of a charity is to be found in the purpose for which the institution is founded and exists and that the motives of, or benefit to, a donor or settlor are immaterial.

Bogert on Trusts, Vol. 2, pp. 1126-7;

Fire Insurance Patrol v. Boyd, 120 Pa. St. 624, 6 A. S. R. 745, 750, 1 L. R. A. 417;

Fordyce & McKee v. Women's Christian Nat. Library Ass'n., 79 Ark. 550, 96 S. W. 155;

Harrison v. Barker Annuity Fund, 98 Fed. (2d) 286;

Union Pacific Railway Co. v. Artist, 60 Fed. 365 (C. C. A. 8th, 1894);

Parsons v. Childs, 345 Mo. 689, 136 S. W. (2d) 327, 332; Cert. den. 310 U. S. 640;

Old Colony Trust Co. v. O. M. Fisher Home, Inc., 301 Mass. 1, 16 N. E. (2d) 10, (1938);

Westport Bank & Trust Co. v. Fable, 126 Conn. 665, 13 Atl. (2d) 862, 866 (1940).

Authorities holding that the fact a non-profit institution makes a charge against members, or that its inmates pay a consideration on their admission, or that a non-profit school or hospital makes some charge to help to defray the cost of its operation, does not affect its charitable character.

Bogert on Trusts, Vol. 2, pp. 1114-15;

Estate of Lowe, 326 Pa. 375, 192 Atl. 405, 111 A. L. R. 518 (1937);

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Andrews v. Young Men's Christian Association, 226 Iowa 374, 284 N. W. 186 (Iowa 1939).

Authorities holding that the restriction of benefits to its own members does not affect a non-profit institution's charitable character.

Bogert on Trusts, Vol. 2, pp. 1124-25;

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City of Indianapolis v. The Grand Master, etc., 25 Ind. 518, 522;

Estate of Lubin, 186 Cal. 326;

Estate of Henderson, 17 Cal. (2d) 853 (1941).

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	2
Argument	8
Conclusion	11
Appendix	13

CITATIONS

Cases:	
Better Business Bureau of Washington, D. C., Inc. v. *United States*, decided November 13, 1945	8
Burr et v. *Porter*, 283 U. S. 230	11
Commissioner v. *Kensico Cemetery*, 96 F. 2d 594	10
District of Columbia v. *Mt. Vernon Seminary*, 100 F. 2d 116	10
Hassett v. *Associated Hospital Service Corp.*, 125 F. 2d 611, certiorari denied, 316 U. S. 672	8
Knapp-Monarch Co. v. *Commissioner*, 139 F. 2d 863	11
Koon Kreek Klub v. *Thomas*, 108 F. 2d 616	9
La Societe Francaise v. *Cal. Emp. Com.*, 56 Cal. App. 2d 534, certiorari denied, 320 U. S. 736	11
Roche's Beach, Inc. v. *Commissioner*, 96 F. 2d 776	10
Scofield v. *Corpus Christi Golf & Country Club*, 127 F. 2d 452	9
Santee Club v. *White*, 87 F. 2d 5	9
Stanford University Book Store v. *Helvering*, 83 F. 2d 710	11
Sweets Co. of America v. *Commissioner*, 40 F. 2d 436	11
Trinidad v. *Sagrada Orden*, 263 U. S. 578	9, 10
United States v. *Proprietors of Social Law Library*, 102 F. 2d 481	10
Statutes:	
California Unemployment Insurance Act (Statutes of 1935, c. 352, as amended)	11
Internal Revenue Code:	
Sec. 1426 (26 U. S. C. 1426)	14
Sec. 1607 (26 U. S. C. 1607)	14
Social Security Act, c. 531, 49 Stat. 620:	
Sec. 811 (42 U. S. C. 1011)	13
Sec. 907 (42 U. S. C. 1107)	13

685231—46——1

Page

Statutes—Continued
Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360:
Sec. 606 (26 U. S. C. Sec. 1426) 14
Sec. 614 (26 U. S. C. Sec. 1607) 15
Miscellaneous:
Treasury Regulations 90, Art. 206 (7) 17
Treasury Regulations 91, Art. 12 15
Treasury Regulations 106, Sec. 402.215 17
Treasury Regulations 107, Sec. 403.215 18
40 Op. A. G. No. 72 (1943) 10

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 834

LA SOCIETE FRANCAISE DE BIENFAISANCE MUTUELLE, A CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 29–55) is reported in 57 F. Supp. 201. The opinion of the Circuit Court of Appeals (R. 196–205) is reported in 152 F. 2d 243.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 3, 1945. (R. 205–206.) The petition for a writ of certiorari was filed on February 11, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether taxpayer was exempt from social security taxes as a corporation organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual within the meaning of Sections 811 (b) (8) and 907 (c) (7) of the Social Security Act and the corresponding provisions of the Internal Revenue Code?

2. Whether the Commissioner was estopped from asserting taxpayer's true social security tax liability because of his prior erroneous ruling that taxpayer was exempt from such taxes?

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions are set forth in the Appendix, *infra*, pp. 13–18.

STATEMENT

The facts as found by the District Court may be summarized as follows:

Taxpayer operates a large general hospital in San Francisco, which admits the general public, as well as it own members, a school for nurses, and a home for aged members. (R. 30, 38, 41, 42, 44). It was incorporated in 1856, under Chapter VIII (relating to "Religious and other Associations or Societies") of the California Corporation Act of 1850. It succeeded an unincorporated beneficial society of the same name which had

been founded in 1851. Its sole purpose has always been the care and treatment of the sick without profit, being founded on the basis of mutuality for the treatment of sick members. (R. 38, 119.) Taxpayer's affairs have been managed by a board of directors, elected annually by the members of the society, who serve without compensation. Taxpayer has never had any capital stock, has never paid dividends or other distributions to any one, and no part of its net earnings has ever inured to the benefit of any private shareholder or individual. (R. 38–39.)[1]

Membership in taxpayer is limited to those of French birth or descent, or to the members of their immediate families or to those who speak French. (R. 30.) The number of members is not limited, and has averaged around 9,700 during the taxable periods here involved. Taxpayer never solicits members and has never paid any commission to obtain new members. Members pay an admission fee and monthly dues of $1.75 except children who pay dues of $1 and life members who pay a flat sum of $1,500, and in return receive medical treatment and hospital care gratuitously, or at less than the normal cost charged nonmember paying patients admitted to the hospital. (R. 30, 43–45.) Only members in good standing re-

[1] The Circuit Court of Appeals concluded, however, that profits may inure to the benefit of a private shareholder other than by monetary dividend payments and that they did so in the instant case. (R. 201–202.)

ceive these privileges and if a member is six months in arrears in his dues he loses his privileges (R. 122, 197), although continued payment of dues is not necessarily a condition to relief for indigent or other needy members and their families who may be treated free of charge at the discretion of the board of directors (R. 43).

From 1937 to and including 1942, approximately 40 percent of taxpayer's gross income was derived from fees paid by nonmembers for hospitalization while 55 percent consisted of members' monthly dues and admissions and reduced fees charged members for hospitalization. The balance was received from dividends, interest and rent on investments owned by taxpayer, miscellaneous sources, and gifts and bequests to it. (R. 45, 154, 198.) Since 1851, legacies, devises and gifts have aggregated over $360,000. Taxpayer acquired its present plant and facilities mainly through testamentary and other gifts. Receipts from members would not have been sufficient therefor. (R. 39.) During the years in question, gifts and bequests have amounted to less than one percent of taxpayer's annual gross income. (R. 154, 199.)

The hospital is approved by the American Medical Association and American College of Surgeons as a "Class A" hospital and accredited for the training of interns of whom there are usually six. (R. 40, 41.) It has a capacity of

225 beds and 15 nursery cribs. (R. 40.) Of the 225 beds it provides two permanent free beds for the treatment of indigent persons under the patronage of the French Ladies Relief Society, and maintains from current income an Old People's Home, with a capacity of 15 beds, for the care of aged and feeble members who are admitted at the discretion of the board of directors and pay according to their ability, but not upon fixed schedules or any profit making basis. (R. 42.) A nurses' training school, with a building built and used exclusively as a training home, is also maintained at an annual cost of about $12,000. Usually 60 or 70 nurses are in training. (R. 41.)

For the eight years prior to 1944, consultations by members at, or calls on members by the medical staff outside, the hospital averaged 26,987 annually. (R. 41.) Free emergency treatment to all deserving cases in the neighborhood consisted on an average of 300 annually, or about 1.1 percent of the members treated. (R. 42–43.)

Any surplus from taxpayer's operations is invested in the hospital plant or held in reserve for that purpose and the members have no interest in the hospital plant and other assets of the society other than the right to use its facilities. (R. 30, 32.)

There has been no change in taxpayer's plan of operations since many years prior to 1936. On July 14, 1937, the then Deputy Commissioner of

Internal Revenue officially notified taxpayer that it was exempt from payment of taxes imposed by the Social Security Act inasmuch as it came within the exception provided in Section 811 (b) (8) of Title VIII and Section 907 (c) (7) of Title IX, and further that it was entitled to exemption under the provisions of Section 101 (6) of the Revenue Act of 1936. (R. 45.) On February 24, 1939, the then acting Commissioner of Internal Revenue notified taxpayer that while it appeared that the corporation was not operated for profit and did engage in substantial charitable activities, it was nevertheless not entitled to exemption from income taxes under the provisions of Section 101 (6) of the Revenue Act of 1938 as a corporation organized and operated exclusively for charitable purposes, and that the ruling contained in the Bureau letter dated July 14, 1937, was modified accordingly. (R. 45–46.) Thereafter on April 3, 1939, the Deputy Commissioner of Internal Revenue notified taxpayer, referring to the communication of February 24, 1939, that it was not entitled to exemption under Section 811 (b) (8) of Title VIII and Section 907 (c) (7) of Title IX of the Social Security Act. (R. 46.)

After receipt of the Bureau ruling of July 14, 1937, taxpayer refunded to its employees all the contributions which theretofore had been deducted from their wages and made no further deductions

until the ruling was reversed by the letter dated April 3, 1939. Taxes, penalties and interest later paid for that interval were paid exclusively from taxpayer's funds without any deductions from employees' wages, nor was taxpayer ever repaid by any employee in whole or in part. (R. 46.)

The findings then set forth the amounts and dates of payments of social security taxes, penalties and interest involved in the action. The aggregate amount paid was $35,269.85. (R. 47–50.) After claims for refund were filed and disallowed, taxpayer instituted the present action. (R. 51–54.)

The District Court concluded that taxpayer since August 14, 1935, the effective date of the Social Security Act, was a charitable corporation within the meaning of Section 811 (b) (8) of Title VIII and Section 907 (c) (7) of Title IX of the Act and corresponding sections of the Internal Revenue Code, and that taxpayer was entitled to judgment for the $35,269.85 taxes, penalties and interest paid, with interest from the dates of payment and its costs of suit. (R. 54–55.)

The Circuit Court of Appeals, however, reversed the judgment of the District Court and held that taxpayer was not a corporation organized and operated exclusively for charitable purposes, was not exempt from payment of social security taxes, and was not entitled to recover

685231—46——2

any of the taxes, interest, and penalties sought, including those amounts paid on behalf of its employees for the period in which it failed to collect the taxes or returned them to the employees under the mistaken view that the original ruling of the Commissioner was correct. (R. 203–205.)

ARGUMENT

1. The decision below specifically follows the ruling of this Court in *Better Business Bureau of Washington, D. C., Inc.* v. *United States,* decided November 13, 1945, No. 52, this Term. (Cf. Pet. Br. 23–26.) Hospital treatment of nonmembers at more than cost clearly was not charitable in nature. This was one of taxpayer's most substantial activities and because of it, under the rule of the *Better Business Bureau* case, the taxpayer was not entitled to the exemption sought. Moreover, the stated purpose for which taxpayer was organized and operated, namely, to supply better and cheaper hospital benefits to its dues paying members, is fundamentally a form of group health or mutual benefit insurance and not within the scope of the exemption provision. *Hassett* v. *Associated Hospital Service Corp.,* 125 F. 2d 611 (C. C. A. 1st), certiorari denied, 316 U. S. 672. To supply hospital treatment to a class of persons may of course be a charitable pursuit under certain circumstances. But there is no reason to conclude that a cooperative hospital is any more a charity

than any other form of cooperative enterprise which enables its members to benefit financially from the mutual association. Moreover, when we consider along with this noncharitable purpose the further fact that the profits made on serving outsiders were used to lower the cost of hospital and medical treatment to the members, we have, as the court below held, violation of the additional exemption requirement that the net earnings must not inure to the benefit of private individuals.

It is claimed, however, that this reasoning conflicts with the holding of this Court in *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, in that it ignores the use to which the funds are put, while erroneously emphasizing their source. But in the *Sagrada Orden* case, dividends, interest, rents, and profits on small sales of wine and chocolates were admittedly directed solely to the institution's religious, charitable and educational pursuits. Here the excess over cost of the fees charged nonmembers was not allocated solely to charitable purposes but was used to lower the cost of treatment for members who scarcely could be classified as, or would consider themselves to be, the recipients of charity. This likewise differentiates the instant case from *Koon Kreek Klub* v. *Thomas,* 108 F. 2d 616 (C. C. A. 5th); *Santee Club* v. *White,* 87 F. 2d 5 (C. C. A. 1st); *Scofield* v. *Corpus Christi Golf & Country Club,* 127 F. 2d 452 (C. C. A.

5th); *Commissioner* v. *Kensico Cemetery*, 96 F. 2d 594 (C. C. A. 2d); *Roche's Beach, Inc.* v. *Commissioner*, 96 F. 2d 776 (C. C. A. 2d); *United States* v. *Proprietors of Social Law Library*, 102 F. 2d 481 (C. C. A. 1st); and *District of Columbia* v. *Mt. Vernon Seminary*, 100 F. 2d 116 (App. D. C.); all alleged to be in conflict (Pet. Br. 30–32), where the income was used only to further the ends which were made the original basis of the exemption.

Taxpayer also contends (Br. 15–23) that the legislative history of the Social Security Act reveals that the mere fact that a hospital is not operated for profit entitles it to the exemption. This is plainly in error, since the emphasis is not upon the nonprofit aspect, but upon the use to which the profits are put. *Trinidad* v. *Sagrada Orden*, *supra*. Obviously, Congress intended to and did exempt the typical hospital, where the fees charged usually are to defray merely part of the cost of service, and whatever profits may be derived from paying patients are allocated together with gifts, bequests, and grants which form not one percent as here but a substantial part of gross income, to the free treatment of the poor. It is this typical hospital which is referred to in the opinion of the Attorney General holding that a nonprofit hospital was exempt. (40 Op. A. G. No. 72 (1943).) The opinion did not relate the exemption to an organization in the nature of a

mutual benefit association where profits derived from nonmembers inured to the private benefit of the members.

Finally, it should be noted that for purposes of the California Unemployment Insurance Act (Statutes of 1935, c. 352, as amended) enacted in co-ordination with Title IX of the Social Security Act, taxpayer has been held to be outside the exemption granted to charitable corporations in virtually the identical language as that used in the federal statute (*La Societe Francaise* v. *Cal. Emp. Com.* 56 Cal. App. 2d 534). The same arguments as those now advanced were relied on in a petition for certiorari filed by taxpayer in that case which was denied. (320 U. S. 736.)

2. The rule is well established by this and the Circuit Courts of Appeals that within the statute of limitations the Commissioner may reverse an erroneous opinion or ruling and assert the taxpayer's true tax liability. *Burnet* v. *Porter,* 283 U. S. 230; *Sweets Co. of America* v. *Commissioner,* 40 F. 2d 436 (C. C. A. 2d); *Knapp-Monarch Co.* v. *Commissioner,* 139 F. 2d 863 (C. C. A. 8th); *Stanford University Book Store* v. *Helvering,* 83 F. 2d 710 (App. D. C.). No conflict in decisions is alleged. (Pet. Br. 33–37.)

CONCLUSION

The decision below is correct and there exists no conflict in decisions or other occasion for further

review. The petition should therefore be denied.

Respectfully submitted

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MARCH, 1946.

APPENDIX

Social Security Act, c. 531, 49 Stat. 620:

TITLE VIII—TAXES WITH RESPECT TO EMPLOYMENT.

* * * * *

SEC. 811. When used in this title—

* * * * *

(b) The term "employment" means any service of whatever nature, performed within the United States by an employee for his employer, except—

* * * * *

(8) Service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(42 U. S. C. 1011.)

TITLE IX—TAX ON EMPLOYEES OF EIGHT OR MORE.

* * * * *

SEC. 907. When used in this title—

* * * * *

(c) The term "employment" means any service, of whatever nature, performed within the United States by an employee for his employer, except—

* * * * *

(7) Service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

* * * * *

(42 U. S. C. 1107.)

These are the same as Sections 1426 (b) (8) and 1607 (c) (7) of the Internal Revenue Code as originally approved on February 10, 1939.

Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360:

SEC. 606. Effective January 1, 1940, section 1426 of the Internal Revenue Code is amended to read as follows:

"SEC. 1426. DEFINITIONS.

"When used in this subchapter—

* * * * *

"(b) *Employment.*—The term 'employment' means any service performed prior to January 1, 1940, which was employment as defined in this section prior to such date, and any service, of whatever nature, performed after December 31, 1939, by an employee for the person employing him, irrespective of the citizenship or residence of either, * * * except—

* * * * *

"(8) Service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the

prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;"
(26 U. S. C. 1426.)

* * * * *

SEC. 614. Effective January 1, 1940, section 1607 of the Internal Revenue Code is amended to read as follows:
"SEC. 1607. DEFINITIONS.
"When used in this subchapter—

* * * * *

"(c) *Employment.*—The term 'employment' means any service performed prior to January 1, 1940, which was employment as defined in this section prior to such date, and any service, of whatever nature, performed after December 31, 1939, * * * except—

* * * * *

"(8) Service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;"
(26 U. S. C. 1607.)

Treasury Regulations 91, promulgated under Title VIII of the Social Security Act (effective through December 31, 1939):

ART. 12. *Religious, charitable, scientific, literary, and educational organizations and community chests.*—Services performed by any employee of an organization of the class specified in section 811 (b) (8) are excepted.

For the purpose of the exception the nature of the service is immaterial; the statutory test is the character of the organization for which the service is performed.

In all cases, in order to establish its status under the statutory classification, the organization must meet two tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes; and

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals.

Corporations or other institutions organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that an organization established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily affect its status under the law.

* * * * *

Since a corporation or other institution to be within the prescribed class must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and also manufactures and sells articles to the public for profit is not within the statutory class even though its property is held in common and its profits do not inure to the benefit of individual members of the organization.

An organization otherwise within the statutory class does not lose its status as such by receiving income such as rent, dividends and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in section 811 (b) (8) of the Act.

Money contributed by members of an organization to a common fund to be applied to the relief of the particular members of the organization or their families when in sickness, unemployed, in want, or under other disability, is not a charitable fund.

* * * * *

Article 206 (7) of Treasury Regulations 90, promulgated under Title IX of the Social Security Act (effective through December 31, 1939), is the same as Article 12 of Treasury Regulations 91.

Treasury Regulations 106, promulgated under the Federal Insurance Contributions Act (effective after January 1, 1940):

SEC. 402.215. *Religious, charitable, scientific, literary, and educational organizations and community chests.*—Services performed by an employee in the employ of an organization of the class specified in section 1426 (b) (8) of the Act are excepted.

For purposes of this exception the nature of the services performed is immaterial; the statutory test is the character of the organization for which the services are performed.

In all cases, in order to establish its status under the statutory classification, the organization must meet the following three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations or other institutions organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that an organization established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily affect its status under the law.

* * * * *

Since a corporation or other institution to be within the prescribed class must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to the public for profit is not within the statutory class even though its property is held in common and its profits do not inure to the benefit of individual members of the organization.

An organization otherwise within the statutory class does not lose its status as such by receiving income such as rent, dividends, and interest from investments, provided such income is devoted exclusively to one or more of the specified purposes.

* * * * *

Section 403.215 of Treasury Regulations 107, promulgated under the Federal Unemployment Tax Act (effective after January 1, 1940) is substantially the same as Section 402.215 of Treasury Regulations 106.

U. S. GOVERNMENT PRINTING OFFICE: 1946